December 5, 2019

Mr. Willie Morales, Administrator City of Appleton 323 W. Schlieman Avenue Appleton, MN 56208-1213

Re: 2018 City of Appleton Audit Review (CWRF/MPFA-04-0005-R-FY06)

Dear Mr. Morales:

The Minnesota Public Facilities Authority (PFA) is in receipt of the City's audited financial statement for the year ending December 31, 2018. The audit is reviewed each year by the PFA in relation to the Note issued by the City to the PFA that financed the City's 2006 wastewater treatment project. As part of this financial transaction, the City issued its 2006 General Obligation Sewer Revenue Note (Note) and executed related bond documents (including a PFA Loan Agreement and Authorizing Note Resolution) all of which include a number of conditions, covenants and terms for the financial assistance.

The 2018 audit shows that the combined Water, Sewer, and Garbage Fund revenues are not sufficient to pay for system operation, maintenance, debt service and depreciation.

Per the City's Authorizing Note Resolution 2006-12, dated July 12, 2006, the City agreed to impose and collect charges sufficient to pay for the service, use, availability and connection to the Sewer System as well as for principal and interest when due on the Note and other outstanding bonds.

The PFA Loan Agreement requires an audit specific to the Sewer Fund be conducted in accordance with generally accepted government auditing standards. It also states that the City will impose and collect charges in the amounts sufficient to pay principal and interest when due at a coverage level not less than 105%.

Listed below are several action items for the City to address:

• We would like your Auditor to provide a supplemental Sewer fund report or break out the Sewer fund from the existing Water/Sewer/Garbage fund into its own separate fund. Either way, we need you to show the Sewer Fund as a standalone fund. At present, it is difficult to determine if the Sewer Fund is generating sufficient revenue to meets its covenants.

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- The City has submitted a DWRF IUP request for your upcoming water project to be financed through the PFA. If we do fund this project, we will require you to also separate out the Water Fund in your audits.
- Please explain why the Water/Sewer/Garbage Fund continues to have a zero cash balance.
- State the purpose of \$1,544,176 Interfund amount, noted on page 39 of the 2018 audit, that is payable to the General Fund.
- Discuss how the City will address the negative operating income situation. Even with depreciation taken out there is a deficit.
- How does the City ensure that revenues are sufficient to cover 105% of debt service costs for the Sewer Bonds/Notes outstanding?
- Has a rate study been done recently? Has a rate increase schedule already been adopted to ensure existing and new debt can be covered?

Please provide a written response informing PFA of the City Council's approved action and timeline to be taken in order to improve the financial condition of the Enterprise Fund, report individual Fund activities separately, and to comply with the covenants of both the Project Loan Agreement, Authorizing Note Resolution and General Obligation Sewer Revenue Note.

I look forward to working with you on these issues. Feel free to contact me with any questions. Thank you for your attention to this matter.

Sincerely,

Kathe Barrett Senior Loan Officer (651)259-7464

Kathe.barrett@state.mn.us